

**International Headquarters**

KPMG Building  
Burgemeester Rijnderslaan 20  
1185 MC Amstelveen  
The Netherlands

**Correspondence Address**

1-2 Dorset Rise  
London  
EC4Y 8AE  
United Kingdom  
Telephone +44 (20) 7694 8089  
Fax +44 (20) 7694 8429  
E-mail mark.vaessen@kpmg.co.uk

Paul Pacter  
Director of Standards for SMEs  
International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

Your ref

Our ref MV/813

Contact Mark Vaessen  
020 7694 8089

29 September 2004

Dear Paul

**Discussion Paper *Preliminary views on Accounting Standards for Small and Medium-sized Entities***

We appreciate the opportunity to respond to the International Accounting Standards Board's discussion paper on its *Preliminary views on accounting standards for small and medium-sized entities*. This letter expresses the views of KPMG International and its member firms.

Our key comments are set out in this covering letter and our detailed responses to the questions posed in the discussion paper are set out in the attached appendix.

*Definition of the SME regime*

We support the development of an IFRS regime for small for medium sized entities (SME regime). However, we are concerned that the current direction of the project will lead to a regime that is not sufficiently different to full IFRSs to be of any practical use.

We note that IFRSs already contain differential disclosure and presentation requirements (e.g., IAS 14 and IAS 33). These are based on whether the entity is 'publicly traded' and we would encourage such derogations to continue to be included in individual standards separately from any regime for SMEs. We would support a comprehensive review of existing IFRSs to determine whether further derogation is appropriate on this basis.

However, we are concerned that the definition of public accountability proposed for the purpose of defining the scope of the SME project is too similar to 'publicly traded' and does not properly describe the vast majority of smaller, less complex SMEs. We believe that this definition is not the appropriate way to define a differential regime for SMEs.



KPMG International is a Swiss cooperative of which all KPMG firms are members. KPMG International provides no services to clients. Each member firm is a separate and independent legal entity and each describes itself as such.

In particular, we are concerned that, by using a definition based on public accountability, the IASB will develop a financial reporting regime that is comparable to full IFRSs minus IAS 14 and 33. We are not convinced that this will be a useful addition to IFRS and may not meet the needs of SMEs, or relevant users of SME financial information.

For this reason, we believe that the determination of a separate regime for SMEs requires a different approach that is focussed on far smaller and less complex entities.

We agree that it will be for national regulators to define which entities are permitted or required to apply the separate regime. The definition of the project's scope is therefore necessary *only* to direct the project and to describe to the national regulators its intended use.

One way that the scope of the project could be defined is by describing qualitatively the characteristics of a small and medium sized entity. For example, an SME may be described as an entity that has no significant financial instruments other than short term receivables/payables and own debt, does not enter into derivatives (embedded or otherwise), does not have biological assets or investment properties, comprises only a single cash generating unit etc.

We accept that determination of the definition will have obvious consequence for the resultant regime and that in this respect such a definition is 'self-serving'. We believe that this is acceptable provided that the definition appropriately describes the majority of SME entities and on the basis that it is for national regulators to determine those entities that are permitted to use the regime.

We consider that this approach will allow the IASB to define a regime that is appropriate for the vast majority of enterprises to which national regulators may wish to apply such a regime. We consider that such an approach is more likely to lead to a regime for SMEs that is sufficiently differential to be of practical use.

In our view, the residual issue is how the IASB / national regulators should address the small number of entities that might be considered to be SMEs on the basis of nationally determined (e.g., *quantitative*) criteria but which do undertake significant transactions that are not dealt with in the SME regime. This is an issue of how the SME regime interacts with full IFRSs and any hierarchy that applies in the differential regime. We consider these issues further in response to questions 4 and 7 in the attached appendix.

#### *Resources*

We believe that the development and continuous update of the SME regime will require a significant resource commitment from the IASB, both in terms of staff and Board time. We would encourage the Board to consider how best to manage this commitment and whether development should be delegated to a working party for approval by the Board. The Board may wish to consider whether a different approach is appropriate to the continuous update phase, for example, it may be preferable to have dedicated staff resources in the initial phase while

continuous update may best be achieved by considering the SME regime at the same time as new or revised IFRSs are developed.

\* \* \*

Please contact Mark Vaessen at 020 7694 8089 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

A handwritten signature in black ink that reads 'KPMG International' in a cursive, flowing script.

*KPMG International*

## Appendix

### **Issue 1 - Should the International Accounting Standards Board (IASB) develop special financial reporting standards for SMEs?**

*Question 1a. Do you agree that full IFRSs should be considered suitable for all entities? If not, why not?*

We agree that full IFRSs should be considered suitable for all entities. However, this does not preclude the existence of a separate regime that also would be suitable for some entities (for example those that are small) and that meets the needs of preparers and users equally well.

*Question 1b. Do you agree that the Board should develop a separate set of financial reporting standards suitable for SMEs? If not, why not?*

We support the development of a differential system of IFRSs for such entities and are aware that many constituents of the IASB have already signalled strong support for a separate set of financial reporting standards suitable for SMEs.

We consider that high quality financial reporting should be attainable for all entities, at a reasonable compliance effort / cost in relation to the benefits of such compliance. Our preference is that such a system be globally consistent for many reasons, including to aid users and to facilitate the development of SMEs through either growth or acquisition.

To achieve global consistency we consider it essential that there exists a set of IASB financial reporting standards that may be applied reasonably easily by smaller entities that have relatively less complex transactions and arrangements (and, accordingly, less in-house accounting expertise).

While we understand that education in the application of full IFRSs has a valuable role to play in the global acceptance of IFRSs, we do not consider that education alone can meet this objective in the case of SMEs. Accordingly, we support the development of a differential system of IFRSs for such entities.

*Question 1c. Do you agree that IASB Standards for SMEs should not be used by publicly listed entities (or any other entities not specifically intended by the Board), even if national law or regulation were to permit this? Do you also agree that if the IASB Standards for SMEs are used by such entities, their financial statements cannot be described as being in compliance with IFRSs for SMEs? If not, why not?*

We agree that a financial reporting regime should not be used where its use is inappropriate and we doubt that a regime designed for SMEs would be appropriate for publicly listed entities. However, we consider that it is for national law and regulations to determine the permitted / required use of a particular financial reporting framework. The IASB should describe clearly the characteristics of any differential financial reporting framework that it develops (as it has done

for full IFRS) in order that national regulators may make an informed decision when determining which entities are permitted / required to apply that framework.

We do not believe that any SME standard should include qualifying criteria for its application, beyond a reference to the requirements of 'national' regulation, as this may lead to conflicts between national requirements and the use of the differential regime.

The SME regime should include disclosure requirements that require the basis of preparation (i.e., the regime used in preparing the financial statements) to be described explicitly in the financial statements.

## **Issue 2 - What should be the objectives of a set of financial reporting standards for SMEs?**

*Question 2. Are the objectives of IASB Standards for SMEs as set out in preliminary view 2 appropriate and, if not, how should they be modified?*

We generally agree with the objectives of IASB Standards for SMEs as outlined in preliminary view 2.

However, we believe that the weighting given to some of these objectives should be greater than that given to others. For example, we expect only a small number of entities to require transition to full IFRSs and this transition is, in any event, facilitated under IFRS 1. Accordingly, while ease of transition to full IFRS is a helpful characteristic of a differential regime for SMEs, it is less important than other stated objectives.

We support the objective to reduce the financial reporting burden on SMEs that want to use global standards. We have doubts however, that the development of IASB Standards for SMEs in accordance with the preliminary views of the IASB as described in the discussion paper will meet this objective. We therefore urge the IASB to reconsider the scope of the project to ensure that sufficient emphasis is placed on this objective in the approach to, and requirements of, any SME regime. We expand upon this concern in the covering letter and in response to question 3 below.

## **Issue 3 – For which entities would IASB Standards for SMEs be intended?**

*Question 3a. Do you agree that the Board should describe the characteristics of the entities for which it intends the standards but that those characteristics should not prescribe quantitative 'size tests'? If not, why not, and how would an appropriate size test be developed?*

We agree that the IASB should not develop size criteria and therefore agree that any description must be qualitative. We believe that it is for national regulators to determine the actual use of the differential regime.

In our view, the IASB need develop a working definition of the entities that it intends to use the new financial reporting framework for the purpose *only* of scoping the project, describing its conclusions and communicating to national regulators its intended scope.

*Question 3b. Do you agree that the Board should develop standards that would be suitable for all entities that do not have public accountability and should not focus only on some entities that do not have public accountability, such as only the relatively larger ones or only the relatively smaller ones? If not, why not?*

We believe that the regime for SMEs should focus on those entities that are smaller and less complex.

We are concerned that the definition of public accountability developed for the purpose of defining the scope of the project is too similar to ‘publicly traded’ (as used in IAS 14 and IAS 33) to be an appropriate basis for distinguishing an additional differential regime designed for SMEs.

Accordingly, we believe that any differential SME regime should be focussed on far smaller and less complex entities than all of those that are not ‘publicly traded’. We believe that the proposed scope of the project is too broad (given the range of companies it would include from large unlisted to micro-companies). As a result, the definition may lead to a standard that does not meet the needs of the constituents of the IASB that have requested the project.

Separate from any SME regime, we support differential disclosure requirements on the basis of ‘publicly traded’ and believe that such derogations can be incorporated into individual IFRSs, as in the case of IAS 14 and 33. We would support a review by the IASB of other IFRSs to consider whether any further derogation is appropriate on the same basis.

*Question 3c. Do the two principles in preliminary view 3.2, combined with the presumptive indicators of ‘public accountability’ in preliminary view 3.3, provide a workable definition and appropriate guidance for applying the concept of ‘public accountability’? If not, how would you change them?*

We would support the use of ‘public accountability’ as **one** element of the working definition, though we ask the IASB to consider the use of the more easily understood ‘publicly traded’.

However, as noted in response to question 3b, we believe that the regime should be focussed on far smaller and less complex entities than all of those that do not have ‘public accountability’ (or that are not ‘publicly traded’). A second element of the definition of an SME is therefore required, to limit the scope of the project to those smaller, less complex entities.

We note that the definition is a working definition only (see question 1). Its sole purpose should be to guide the scope of the project and then to communicate the intended scope of the resulting regime to national regulators.

In determining the second element of the definition, the IASB should consider the common characteristics of entities that currently are permitted to use differential regimes on the basis of size, for example in the European Union. This approach will allow the IASB to adopt a working definition of an SME that is more consistent with the large number of smaller, generally less complex entities.

One way that the scope of the project could be defined is by describing qualitatively the characteristics of a SME. For example, an SME may be described as an entity that has no significant financial instruments other short term receivables / payables and own equity / debt, does not enter into derivatives (embedded or otherwise), does not have biological assets or investment properties, comprises only a single cash generating unit etc.

We accept that the definition will have obvious consequences for the resultant regime and that in this respect the definition is ‘self-serving’. We believe that this is acceptable provided that the definition appropriately describes the majority of SME entities and given that it is for national regulators to determine those entities that are permitted to use the regime.

We consider that this approach will allow the IASB to define a regime that is appropriate for the vast majority of enterprises that national regulators may wish to apply such a regime. We consider that such an approach is more likely to lead to a regime for SMEs that is sufficiently differential to be of practical use.

In our view, the residual issue is how the IASB / national regulators should address the small number of entities that might be considered to be SMEs on the basis of nationally determined (e.g., *quantitative*) criteria but which do undertake significant transactions that are not dealt with in the SME regime. In part, this is an question of how the SME regime interacts with full IFRSs and any hierarchy that applies in the SME regime. We consider these issues further in response to questions 4 and 7.

*Question 3d. Do you agree that an entity should be required to use full IFRSs if one or more of the owners of its shares object to the entity’s preparing its financial statements on the basis of IASB Standards for SMEs. If not, why not?*

No. We believe that it is for national regulators to determine the eligibility criteria for use of the SME regime. We do not agree that the IASB should add additional criteria but would support that IASB ‘suggesting’ possible criteria to the various regulators, perhaps in an introduction to the regime.

The agreement (or probably more appropriately the non-objection) of shareholders is one such possible eligibility criterion. The IASB may wish to consider whether the suggested criteria should be *all* shareholders or, alternatively, a minimum voting percentage, e.g. 5% or more of the voting rights to require the entity to apply full IFRSs. Such a threshold will lessen the risk of an entity flip-flopping annually from full IFRS to the SME regime if shareholdings change.

*Question 3e. Do you agree that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of its parent, venturer or investor, the entity should comply with full IFRSs, and not IASB Standards for SMEs, in its separate financial statements? If not, why not?*

We consider that it is for national regulators to determine the eligibility criteria for the use of the SME regime. However, we would disagree with the proposed criteria also on principle.

We do not believe that an entity should be precluded from using the SME regime solely as a result of the financial reporting relevant to its parent/investor, or as a result of group reporting requirements. Such a requirement would be inconsistent with other areas of IFRSs. For example, there is no requirement that an entity comply with full IFRSs because its parent does.

**Issue 4 - If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?**

*Question 4. Do you agree that if IASB Standards for SMEs do not address a particular accounting recognition or measurement issue, the entity should be required to look to the appropriate IFRS to resolve that particular issue? If not, why not, and what alternative would you propose?*

We believe that any 'hierarchy' to be included in the SME regime will require careful consideration. We also consider that the appropriate approach will depend upon the degree of modifications made to recognition and measurement requirements (see response to question 7).

In a principles-based system such as IFRS (full or SME), there will always be debate as to what approach to follow when a particular accounting recognition or measurement issue is not addressed (i.e., when a 'gap' exists in stated principles or in application guidance). We believe that this will be the case particularly in the SME regime, where it is likely that the requirements are distilled down to principles with far less application guidance for a range of facts or circumstances.

The inclusion of a mandatory fallback to full IFRS may therefore defeat the objective of the regime – in order to identify that a gap exists and that that particular gap is narrowed by full IFRSs, the entity applying the SME regime is required to know the difference in content between the two regimes and therefore, by inference, to know and understand full IFRSs.

As noted in the discussion paper, it is questionable whether such required knowledge is consistent with the stated objective to simplify the application of an SME regime and so reduce the financial reporting burden.

As noted above, we consider that the appropriate nature of any hierarchy will depend upon the extent of the modifications made to the recognition and measurement requirements of full IFRSs. Assuming that there are a limited number of identified modifications, it may be possible to include a focussed hierarchy in respect of clear gaps, but not to include a general requirement for fallback to IFRS as follows:

- In the case of a clearly identified 'gap' that the IASB considers should be the subject of additional guidance under certain circumstances, a focussed hierarchy could require



reference to such guidance (e.g., to particular paragraphs of the relevant IFRS); for example, in the case of an entity with significant embedded derivatives, if the differential regime did not require the separate recognition of such derivatives.

- In areas where a focussed hierarchy is not considered necessary, the SME regime would require the application of judgement to determine an appropriate accounting policy by analogy within the SME regime (and the framework of the regime). The selected policy and its use would be disclosed. Reference to full IFRSs would not be required.

Effectively, any gaps that were not the subject of a focussed hierarchy would be assumed to be intentional. For example, in the case of employee benefit schemes the SME regime may only set out the accounting for defined contribution schemes. SMEs with defined benefit schemes may be required to follow a supplement which sets out the principles of defined benefit accounting based on IAS 19. However the supplement may be silent on, for example, the treatment of plan amendments. In this case an SME with a defined benefit scheme with a plan amendment can determine their own accounting policy, following the principles of defined benefit accounting set out in the defined benefit supplement. The SME would not be required to follow the requirements of IAS 19 in this area and this could be specifically stated.

This approach would allow a regime that is focussed on the vast majority of SMEs and that deals with the minority of entities with significant transactions that are ‘unusual’ for SMEs separately. It would avoid a requirement to know and understand full IFRSs merely in order to judge when there exists a gap in principles or application guidance.

**Issue 5 - May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB Standard for SMEs?**

*Question 5a. Should an SME be permitted to revert to an IFRS if the treatment in the SME version of the IFRS differs from the treatment in the IFRS, or should an SME be required to choose only either the complete set of IFRSs or the complete set of SME standards with no optional reversion to individual IFRSs? Why?*

*Question 5b. If an SME is permitted to revert to an IFRS, should it be:*

- required to revert to the IFRS in its entirety (a standard-by-standard approach);*
- permitted to revert to individual principles in the IFRS without restriction while continuing to follow the remainder of the SME version of the IFRS (a principle-by-principle approach); or*
- required to revert to all of the principles in the IFRS that are related to the treatment in the SME version of that IFRS while continuing to follow the remainder of the SME version of the IFRS (a middle ground between a standard-by-standard and principle-by-principle approach)?*

*Please explain your reasoning and, if you favour (c), what criteria do you propose for defining 'related' principles?*

In principle, we believe that the SME regime is a standalone regime, with a hierarchy for gaps (see question 4).

We believe that the most appropriate approach to voluntary reversion to IFRSs depends upon whether or not the SME regime is an incremental step towards full IFRS based on the same underlying framework (i.e., whether the principles of the SME regime are consistent with the principles of full IFRSs such that compliance with full IFRSs, or individual aspects thereof, will always result in compliance with the SME regime).

If the SME regime is not an incremental step towards full IFRS then voluntary reversion, in part, to full IFRSs should be prohibited. This would be the case where, for example, the SME regime required historical cost accounting without exception. Reference to particular aspects of full IFRSs (e.g., to measure investment property at fair value), would be incompatible with the SME regime and would not permit a statement of compliance with that regime.

However, if the differential regime is effectively an incremental step towards for IFRSs we believe that an entity should not be prohibited from choosing to move, incrementally, closer to IFRSs. This would be the case where, for example, the SME regime contained the principle that interest income be recognised on a systematic basis (so permitting straight line or other methods) and an entity wished to adopt the requirements of full IFRSs to use an effective interest rate method.

The approach adopted will need to be consistent with the application of the hierarchy (see question 4).

We believe that the residual issue is one of communication. We consider that the entity would state in a basis of preparation that the financial statements are prepared in compliance with the SME regime. The basis of preparation would go on to describe that, in complying with the SME regime, the entity had additionally applied the more onerous requirements drawn from full IFRS in certain stated respects. The relevant reporting framework would continue to be the SME regime and it is this that would be the basis of the true and fair view. Full IFRSs would be the relevant accounting framework only if all IFRSs were applied.

**Issue 6 – How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?**

*Question 6. Do you agree that development of IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and the principles and related mandatory guidance from IFRSs (including Interpretations), and then making modifications deemed appropriate? If not, what approach would you follow?*

We generally agree that the IASB Standards for SMEs should start by extracting the fundamental concepts from the Framework and IFRSs. Subsequently, appropriate modifications should be made to meet the stated objectives.

**Issue 7 - If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?**

*Question 7a. Do you agree that any modifications for SMEs to the concepts or principles in full IFRSs must be on the basis of the identified needs of users of SME financial statements or cost / benefit analyses? If not, what alternative bases for modifications would you propose, and why? And if so, do you have suggestions about how the Board might analyse the costs and benefits of IFRSs in an SME context?*

We agree that any modifications to the concepts or principles of full IFRSs in the IASB Standards for SMEs should be based on the users' needs or cost benefit analyses. We believe that these two triggers for modifications are equally important and when the additional benefit of a requirement does not outweigh the additional cost it should be modified.

We also consider that the IASB must take into consideration the complexity of SMEs. Based on a definition of an SME that is focussed on smaller, less complex entities (see question 3), we believe that the IASB may be able to consider significant simplifications to full IFRSs. For example, how many SMEs have multiple Cash Generating Units? How often will separate recognition of an embedded derivative for a cap on an SME's single bank loan have a material impact on its financial reporting?

We consider that the IASB may be able to define a regime for a notional SME whose characteristics are described on a qualitative basis in terms of the transactions and arrangements that it undertakes.

We acknowledge that a simplified regime determined on this basis may not deal with every transactions that every SMEs undertakes; particularly where the SME operates in a 'specialised' business – for example a small entity that trades derivatives. We believe that there may be two (possibly interrelated) solutions to these cases:

- the IASB could explore with national regulators whether it is for those regulators to preclude the use of the differential regime by entities that engage in significant transactions that are not envisaged for SMEs; and / or
- the hierarchy in the differential regime could direct to particular parts of full IFRSs the small number of entities with transactions that, if significant to the entity, are not dealt with appropriately by the differential regime (i.e., a focussed hierarchy, see response to question 4).

*Question 7b. Do you agree that it is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost / benefit analyses and that the disclosure modifications could increase or decrease the current level of disclosure for SMEs? If not, why not?*

We agree that disclosure and presentation modifications will be justified and that they may represent an increase or decrease over full IFRSs. We note that IFRSs already contain differential disclosure and presentation requirements (e.g., IAS 14 and IAS 33). We note that these differential disclosure requirements are based on a notion of publicly traded and would encourage such derogations to continue to be made in individual standards.

*Question 7c. Do you agree that, in developing standards for SMEs, the Board should presume that no modification would be made to the recognition or measurement principles in IFRSs, though that presumption could be overcome on the basis of user needs and a cost / benefit analysis? If not, why not?*

We believe that modifications to recognition and measurement principles are appropriate when such a modification is justified based on users needs or a cost / benefit analysis. For example, it may be likely that some simplification of the requirements for financial instrument is appropriate. We believe that recognition and measurement modification may be more likely if the project focussed on smaller SMEs rather than on the larger and more complex entities that would fall within its current scope (based on public accountability). See our response to question 1.

We would support the application of a rebuttable presumption that no modification be made to recognition and measurement requirements if that presumption was capable of rebuttal based on a due-process consideration of users needs or a cost / benefit analysis. We consider that the appropriate approach is to consider each potential modification on its own merits on the basis of such an analysis.

## **Issue 8 - In what format should IASB Standards for SMEs be published?**

*Question 8a. Do you agree that IASB Standards for SMEs should be published in a separate printed volume? If you favour including them in separate sections of each IFRS (including Interpretations) or some other approach, please explain why.*

*Question 8b. Do you agree that IASB Standards for SMEs should be organised by IAS/IFRS number rather than in topical sequence? If you favour topical sequence or some other approach, please explain why.*

*Question 8c. Do you agree that each IASB Standard for SMEs should include a statement of its objective, a summary and a glossary of key terms?*

We believe that the separate regime for SMEs should be clearly distinct from full IFRSs and be easy to use. Both of these objectives are met by publishing the IASB regime for SMEs as a separate volume.

To achieve a level of consistency with the current order of the full standards, we consider that the SME regime should be organised by IAS/IFRS number. This approach will also facilitate the focussed hierarchy that we discuss in response to question 4 above.

We agree that the regime as a whole should contain an objective, a summary and a glossary of key terms. The introduction to each individual standard should contain any additional objectives relevant to that standard.

**Any other matters**

*Question 9. Are there any other matters related to how the Board should approach its project to develop standards for SMEs that you would like to bring to the Board's attention?*

None